

[Assembly Bill 1326](#) (Gloria)

Date: February 22, 2019 (Introduced)

Program: Property Taxes

Sponsor: Author

Revenue and Taxation Code Sections 214 and 259.15

Effective: Upon Chaptering

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**Summary:** This bill extends indefinitely the low-income housing property tax exemption for a rent-restricted unit occupied by an over-income tenant (over 80 percent of Area Median Income (AMI)) – up to 140 percent of AMI – who was income-qualified at first occupancy.

**Fiscal Impact Summary:** No immediate, additional revenue loss.

**Existing Law:** Existing law allows property used for lower income rental housing that is owned and operated by a qualifying nonprofit organization to be exempt from property tax under the welfare exemption, provided various conditions and requirements are met. Lower income rental housing owned by a limited partnership in which a nonprofit organization serves as the managing general partner may also qualify for exemption. Generally, to qualify for the exemption, the law requires that the rental housing be financed with specified tax exempt bonds, government loans or grants, or that the property's owner receives low-income housing tax credits (LIHTC) pursuant to section [42](#) of the Internal Revenue Code (IRC).<sup>1</sup>

**Lower Income Household Definition.** Property tax law defines lower income households by cross-reference to the Health and Safety Code.<sup>2</sup> This law generally provides that lower income households are those households with incomes at 80 percent of the AMI adjusted for family size and geographic areas of the state. The law requires California's Housing and Community Development (HCD) to annually publish these income limits based on federal Housing and Urban Development (HUD) data.

**Proportional Exemption.** The exemption extends to "units serving lower income households" and to qualify, a unit must be occupied by a lower income household (max income 80 percent of AMI).<sup>3</sup> The law allows these rental housing properties a partial exemption equal to that percentage of the value of the property that is equal to the percentage that the number of units serving lower income households represents of the total number of residential units.<sup>4</sup>

**Low-Income Housing Tax Credit Eligibility.** The Internal Revenue Code provides that a low-income unit will continue to be treated as a low-income unit if the occupant's income initially met the income limitation and the unit continues to be rent-restricted. Federal law further provides, as specified, that if the occupant's income exceeds 140 percent of federal law income limitations,<sup>5</sup> then the next available unit in the property of a comparable or smaller size must be rented to a low-income tenant. If not, the

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<sup>1</sup> Revenue and Taxation Code (RTC) sections [214\(g\)\(1\)\(A\)](#) and [214\(g\)\(1\)\(B\)](#). Rental housing without government assistance in the form of low-income housing tax credits or government financing can also qualify, but the exemption is limited to the first \$20,000,000 in assessed value and it must be 90 percent low-income occupied.

<sup>2</sup> Health and Safety Code section [50079.5](#). Additionally, the Board of Equalization (BOE) [annually reports](#) the household income limits to assessors for use in administering the low-income housing exemption.

<sup>3</sup> RTC section [214\(g\)\(3\)\(C\)](#).

<sup>4</sup> RTC section [214\(g\)\(1\)](#).

<sup>5</sup> IRC section [42\(g\)\(2\)\(D\)](#).

*This staff analysis is provided to address various administrative, cost, revenue, and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.*

unit occupied by the household with over 140 percent income threshold ceases to be treated as a low-income unit.

Owners of low-income rental housing properties receiving federal low-income housing tax credits may continue to receive the property tax exemption on units occupied by tenants whose household income increases after move-in to a level above the property tax related income limit of 80 percent of AMI up to the federal law related limit of 140 percent of AMI provided the units remain rent-restricted. Under these provisions, the property owner must provide additional specified information with their annual welfare exemption claim. No property tax exemption is available if the income of the occupants of the unit increases above 140 percent of AMI, adjusted for family size. These provisions are operative for fiscal years 2018-19 to 2027-28.<sup>6</sup>

**Proposed Law:** This bill deletes the 2027-28 fiscal year sunset date, thereby extending indefinitely the low-income housing property tax exemption for a rent-restricted unit occupied by an over-income tenant (over 80 percent of AMI) who was income-qualified at first occupancy.

**In General:** Under section 4(b) of article XIII of the California Constitution, the Legislature has the authority to exempt property (1) used exclusively for religious, hospital, or charitable purposes, and (2) owned or held in trust by nonprofit organizations operating for those purposes. This exemption from property taxation, popularly known as the *welfare exemption*, was first adopted by voters as a constitutional amendment on November 7, 1944.

When the Legislature enacted RTC section 214 to implement this constitutional provision in 1945, a fourth purpose, scientific, was added to the three mentioned in the Constitution. RTC section 214 parallels and expands upon the Constitutional provision by exempting property used exclusively for the stated purposes (religious, hospital, scientific, or charitable), owned by qualifying nonprofit organizations, if certain requirements are met. An organization's primary purpose must be either religious, hospital, scientific, or charitable. Whether its operations are for one or more of these purposes is determined by its activities. A qualifying organization's property may be exempted fully or partially from property taxes, depending on how much of the property is used for qualifying purposes and activities.

RTC section 214 is the primary welfare exemption statute in a statutory scheme that consists of more than 20 additional provisions. Over the years, the scope of the welfare exemption has been expanded by both legislation and numerous judicial decisions. In general, the following requirements must be met before property is eligible for exemption:

- The property must be irrevocably dedicated to religious, hospital, scientific, or charitable purposes.
- The owner must not be organized or operated for profit and must be qualified as an exempt organization, under a specific federal or state statute, by the Internal Revenue Service or the Franchise Tax Board.
- No part of the net earnings of the owner may inure to the benefit of any private shareholder or individual.
- The property must be used for the actual operation of the exempt activity.

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<sup>6</sup> RTC sections 214(g)(2)(A)(iii) and [259.15](#).

The Board of Equalization (BOE) and the 58 county assessors jointly administer the welfare exemption. The BOE determines whether the organization is eligible to receive the welfare exemption and, if eligible, issues an Organizational Clearance Certificate (OCC) for the claimant to provide with applications filed in any of the 58 counties. The county assessor determines whether the use of the property is eligible for the exemption. Once the BOE has issued an OCC, applications for exemption of property are filed with the county assessor where the property is located. The assessor is responsible for granting or denying the welfare exemption.

**Property with Government Financing or Tax Credits: Unlimited Exemption.** Under existing law, when a nonprofit organization owns and operates a low-income rental housing property that receives government financing or low-income housing tax credits, all of the properties may be exempt from property tax. Generally, a low-income rental housing property<sup>7</sup> may qualify for the welfare exemption provided:

- **Government Financing or Tax Credits.** The property owner receives low-income housing tax credits or government financing on the property. *RTC section 214(g)(1)(A) and (B)*
- **Use Restriction.** The property is subject to a recorded deed restriction, regulatory agreement, or "other legal document" restricting its use for low-income housing purposes at specified rents. *RTC section 214(g)(2)(A)(i) and Property Tax Rule [140](#)*
- **Rents Charged.** The rents charged to lower income household occupants do not exceed the rent prescribed by the deed restrictions or regulatory agreement. *RTC sections 214(g)(1)(A) and 214(g)(2)(A)(i)*
- **Property Tax Savings.** The owner certifies that the funds otherwise necessary to pay property taxes are instead used to maintain the affordability of, or reduce rents for, units occupied by the lower income households. *RTC section 214(g)(2)(B)*
- **Limited Partnership—Special Requirements.** In the case of housing owned by a limited partnership in which the managing general partner is an eligible nonprofit corporation or an eligible LLC,<sup>8</sup> use and rent restrictions must be contained in an enforceable and verifiable agreement with a public agency or in a recorded deed restriction. *RTC section 214(g)(2)(A)(ii) and Property Tax Rule 140*

While there is no minimum percentage of units that must be occupied by lower income households, the exemption only extends to the units serving lower income households. *RTC section 214(g)(1)*

Current law requires property owners to annually file a claim to receive the exemption. The claim must state the number of units serving lower income households, including temporarily vacant units that are held for such households, and requires an attachment that lists qualified households.<sup>9</sup>

**Background:** Commencing with the 2018-19 fiscal year, Assembly Bill [1193](#) (Stats. 2017, ch. 756) extended the low-income housing property tax exemption to a rent-restricted unit occupied by an

<sup>7</sup> Such property may include single-family residences, multifamily residences (e.g., duplex, triplex, fourplex), and apartment complexes.

<sup>8</sup> See Property Tax Rule [136](#).

<sup>9</sup> RTC section 214(g)(3)(C). Vacant units in elderly and handicapped unit that qualify under moderate income under RTC section 214(g) are not eligible for exemption.

over-income tenant (up to 140 percent of AMI), who was income-qualified at first occupancy, as long as the property receives federal low-income housing tax credits. Proponents of AB 1193 stated that deed or regulatory restrictions generally prohibited the owner of these properties from evicting tenants for being over-income or increasing the over-income tenants' rent. Additionally, units with over-income tenants continued to qualify as lower income units for tax credit purposes; however, owners would lose their property tax exemption on them, creating a financial hardship.

### **Commentary:**

1. **Effect of This Bill.** Currently, the low-income housing property tax exemption for a rent-restricted unit occupied by an over-income tenant (over 80 percent of AMI) who was income-qualified at first occupancy will sunset with the 2027-28 fiscal year. This bill would make these provisions applicable indefinitely.
2. **Property tax hardship.** Proponents state that deed or regulatory restrictions generally prohibit the owner of these properties from evicting tenants for being over-income or increasing the over-income tenant's rent. The resulting property tax "savings" become a loss on these units and present a financial hardship to the property owners, since rents remain restricted, but property taxes increase.
3. **Related Legislation.**
  - Assembly Bill [1453](#) proposes to amend RTC section 214 to extend for property used exclusively for low-income rental housing to property owned by a limited partnership and leased to a limited partnership in which the managing general partner is an S corporation that is wholly owned by an exempt organization.
  - AB [1734](#) proposes to amend section 214 to extend the welfare exemption to rental units serving moderate income households.
  - Senate Bill [196](#) proposes to extend the welfare exemption to property owned by a community land trust or limited equity housing cooperative.
  - Senate Bill [294](#) proposes to extend the \$20,000,000 exemption limitation to \$250,000,000 and decrease the percentage of occupants that are lower income households required to qualify for exemption from 90 percent to 50 percent.

**Costs:** The BOE would incur absorbable costs to update the claim affidavit (BOE-267-L3), Property Tax Rule 140, and Assessors' Handbook Section 267, *Welfare, Church, and Religious Exemptions*, as well as address ongoing implementation issues.

**Revenue Impact:** Assembly Bill 1326 extends the provisions of RTC section 214(g)(2)(A)(iii) for an unlimited time, which in and of itself does not create any immediate, additional revenue loss.